

P-404, 421, 430, 407, 405, 520, 426/CP-89-1039 ORDER REQUIRING
REFILED COST STUDIES AND PROPOSED RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
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In the Matter of a Petition for
Extended Area Service Between
the Monticello Exchange and the
Minneapolis/St. Paul
Metropolitan Calling Area

ISSUE DATE: December 4, 1992

DOCKET NO. P-404, 421, 430, 407,
405, 520, 426/CP-89-
1039

ORDER REQUIRING REFILED COST
STUDIES AND PROPOSED RATES

PROCEDURAL HISTORY

I. Proceedings To Date

On October 1, 1990, the Commission issued an Order in this matter directing Bridge Water Telephone Company (Bridge Water), the local exchange company (LEC) serving Monticello, and the LECs serving the petitioned Minneapolis/St. Paul metropolitan calling area (MCA) to file cost studies and proposed rates within 60 days. The Commission directed the Minnesota Department of Public Service (the Department) to file its reports and recommendations on those cost studies and proposed rates within 45 days thereafter.

By early December 1990, all required cost studies and proposed rates were filed.

On July 16, 1991, the Commission issued an Order requiring U S West Communications, Inc. (USWC) and Bridge Water to meet to resolve the meet point issue that affected the usefulness of the companies' cost studies. The Commission directed the involved telephone companies to refile their cost studies and proposed rates within 30 days after USWC and Bridge Water agreed upon a meet point.

On November 19, 1991, the Commission granted the Department a 30-day extension to allow the parties to resolve the meet point issue without a contested case hearing.

On January 27, 1992, the Department filed a letter informing the Commission that USWC and Bridge Water reached agreement on the

meet point issue on January 14, 1992. Pursuant to the Commission's July 16, 1991 Order in this matter, revised cost studies and proposed rates using that agreed meet point were due from all the involved telephone companies within 30 days of that agreement, i.e. on or before February 14, 1992.

On February 6, 1992, USWC filed a letter indicating that it would file its revised cost studies and proposed rates for the Monticello petition within 75 days after the Commission's January 29, 1991 Order which denied reconsideration of the Commission's November 26, 1991 Order in Docket No. P-401/CP-89-951, the Hokah case. In addition, USWC indicated that its revised cost studies and proposed rates would exclude its toll contribution for toll routes where USWC serves as the toll provider between independent exchanges.

On February 13, 1992, Bridge Water filed its cost studies and proposed rates and noted that it was updating its traffic information.

On February 27, 1992, Bridge Water filed an objection to the methodology USWC indicated it would use to develop cost studies and proposed rates for the Monticello to MCA route. Bridge Water argued that USWC wrongly assumed that its toll contribution was to be excluded from calculation of Monticello's EAS rates.

On March 9, 1992, Commission Staff established a comment period ending April 13, 1992 and a reply comment period ending April 27, 1992 for interested parties to comment on Bridge Water's February 27, 1992 filing.

On April 10, 1992, the Commission issued its ORDER SETTING DEADLINE FOR REVISED COST STUDIES AND PROPOSED RATES AND REQUIRING LOWER COST ALTERNATIVE. The Commission directed the companies' to refile their cost studies and proposed rates to take into account the meet point agreement, changes in the metropolitan calling area since the studies were originally filed in 1990 and improvements in cost study methodology. The Commission also directed Bridge Water to file a proposal for a lower priced alternative to mandatory flat-rate EAS. Finally, the Commission solicited comments regarding Bridge Water's February 27, 1992 filing, its lower priced alternative proposal, and the companies' cost studies and proposed rates.

On or about April 13, 1992, the involved companies filed cost studies and proposed rates.

On April 13, 1992, the Department and USWC filed comments regarding Bridge Water's February 27, 1992 filing. On April 15, 1992, United Telephone Company (United) also filed comments.

On April 27, 1992, USWC, the Department and Bridge Water filed reply comments.

On April 27, 1992, the Department filed its report and recommendations.

On July 13 and August 14, 1992, USWC and Bridge Water, respectively, filed response comments on the Department's report on the lower priced alternative.

On October 13, 1992, the Commission met to consider this matter. On October 27, 1992, the Commission met on its own motion to reconsider its decision regarding the rate of return on equity that USWC and Bridge Water would use in the cost studies used to calculate EAS rates in this matter.

FINDINGS AND CONCLUSIONS

II. Scope of the Order

This Order focuses on two subjects: (1) the cost studies and proposed rates that the Commission will use to determine the EAS rates that will appear on ballots distributed to Monticello subscribers and (2) the lower priced alternative to flat-rate EAS that Bridge Water will make available to Monticello subscribers.

A. Cost Studies and Proposed Rates

In evaluating the cost studies and proposed rates filed by the companies in this matter, the Commission will examine four questions. First, should the involved telephone companies use the lower rates approved in the Metro Tier Rate Case to determine the percentage of revenue that must be recovered from Monticello subscribers and refile their proposed rates accordingly? Second, is USWC an "affected telephone company" with respect to routes which it currently serves solely as an IXC (i.e. the routes between Monticello and other MCA ILEC exchanges) so that EAS' impact on USWC's toll revenue should be reflected in the rate established for Monticello ratepayers? Third, are the rates of return used by USWC and Bridge Water in their cost studies appropriate to use in calculating EAS rates? Fourth, must Bridge Water provide a copy of its lease with its affiliate U S Link before the reasonableness of its cost study may be assessed?

1. Metro Tier Rates

When an exchange such as Monticello petitions for EAS to the MCA, the general rule is that 75 percent of the costs of providing that EAS is allocated to the petitioning exchange and 25 percent to the existing MCA exchanges. Minn. Stat. § 237.161, subd. 3 (a) (1990). However, if that allocation would result in the

petitioning exchange having lower rates (regular flat rate plus the EAS additive) than an MCA exchange that is adjacent to it, a greater portion of the EAS costs must be allocated to the petitioning exchange until its rates equal those of the adjacent MCA exchange or all costs have been allocated to it, whichever comes first. Minn. Stat. § 237.161, subd. 3 (a) (1990).

The companies filed rates that allocated 77.16 percent of the costs to Monticello. The companies apparently did this so that, as required by the statute, Monticello's rates would be equal to those of Elk River, an MCA exchange adjacent to Monticello. However, subsequent to the filing of their proposed rates, the Commission replaced USWC's tier rate system with uniform residential and commercial rates for all USWC exchanges in the metro area including Elk River. See the Commission's Order issued September 20, 1992 in Docket No. P-421/ 405, 407, 430, 426, 520, 427/CI-87-76. Under the new uniform rates, Elk River's residential and business rates have been significantly reduced. For example: the rate adopted for Elk River's one-party residential customers was \$14.59 per month, a \$3.31 or 18.49 percent reduction and the rate for its business customers was reduced \$9.93 or 18.49 percent to \$43.78 per month.

In light of the significant reduction of Elk River's rates, it may not be justified to allocate more than 75 percent of the EAS costs to Monticello. The Commission will require the companies to recalculate and resubmit proposed rates taking into account the reduction in Elk River's rates. See Ordering Paragraph 1 on page 15 of this Order.

2. USWC as an Affected Telephone Company

a. Background

Minn. Stat. § 237.161, subd. 3 (b) (1990) requires the Commission to establish EAS rates that do not alter the income level of any "affected telephone company". At issue in this matter is whether USWC, in connection with routes between Monticello (served by an ILEC) and other MCA ILEC exchanges which USWC serves solely as an IXC (hereinafter "the routes in question"¹), is an "affected telephone company". If so, USWC's income for these routes would

¹ All parties agree that for routes between Monticello and MCA exchanges for which USWC serves and will continue to serve as the LEC, USWC is an "affected telephone company" for purposes of Minn. Stat. § 237.161, subd. 3 (b) (1990). For such routes, rates will be calculated to maintain USWC income neutral. While it is theoretically possible to separate USWC in its capacity as IXC from its function as a LEC in such exchanges and, hence, to disregard its bottom-line experience as an IXC, it is impossible to do so as a practical matter because USWC operates its IXC and LEC activities as an integrated system and likewise keeps its books for these transactions in an integrated manner.

have to be maintained constant ("neutral") by the EAS rates established in this matter. Installation of EAS for the routes in question would eliminate USWC's role as toll provider over those routes. Because USWC currently loses money on those toll routes in the aggregate, their elimination would result in a net income increase for USWC.²

To neutralize this increase in USWC's net toll income, the Commission would establish EAS rates that did not reimburse USWC for all the EAS costs it experienced in providing EAS over the routes in question but instead would only reimburse USWC's adjusted EAS costs, i.e. its EAS costs minus the amount of increased income it would experience through the elimination of its toll revenue losing routes. In this case, EAS rates for Monticello and the other MCA exchanges would, of course, be lower than if all USWC's EAS costs were reimbursed.³

b. The Parties' Positions Analyzed

1) USWC

USWC asserted that it is not an "affected telephone company" with respect to the proposed routes between Monticello and other independent exchanges within the MCA which it serves solely as

² In this case, USWC serves as one of several IXCs between Monticello and all the MCA exchanges. For USWC, short-haul toll calls cost more to complete (access fees to the LECs and other IXC costs) than it collects from endusers in toll charges. In short, its short-haul routes are revenue losing routes for USWC. If the proposed EAS is installed, the EAS network will link the lines of all the LECs serving the expanded MCA. All calls between Monticello and the MCA exchanges will be local and the special role of the IXC will be eliminated. With the elimination of these revenue losing toll routes USWC will experience an increase in its net income.

³ Each telephone company that would experience costs in providing the expanded service is required to file cost studies indicating these costs in detail. The sum of all those costs is called the overall revenue requirement for the proposed EAS. These costs are recovered 1) partly through EAS rates paid by subscribers in the petitioning exchange (and rates charged for the lower priced alternative to the EAS) and 2) partly through EAS rate additives paid by subscribers in the petitioned exchanges. To keep USWC income neutral, its EAS cost figure would be adjusted by the amount of increased income it would experience through the elimination of these toll revenue losing routes. USWC's adjusted EAS cost figure, then, would be used in calculating the overall revenue requirement for the proposed EAS, thereby reducing the amount of costs allocated to Monticello and the petitioned exchanges, and consequently the rates required to recover those reduced allocations.

the toll provider (hereinafter "the routes in question") and, therefore, need not be maintained income neutral with respect to them. Accordingly, USWC calculated proposed rates without factoring in the increase in income it will experience if EAS is installed over those routes.

USWC stated that its proposal was consistent with the Commission's November 21, 1991 and January 29, 1992 Orders in Docket No. P-401/CP-89-951, et al., hereinafter referred to respectively as the Hokah Order and the Hokah Order After Reconsideration or collectively as the Hokah Orders.

2) Bridge Water

Bridge Water objected to USWC's proposal, asserting that USWC was an "affected telephone company" within the meaning of Minn. Stat. § 237.161, subd. 3 (b) (1990) even with respect to routes for which it served only as an IXC. As an "affected telephone company," USWC's income must be held constant by the EAS rates adopted in this matter.

In support of its position that USWC is an "affected telephone company" for the routes in question, Bridge Water argued that the Hokah Orders did not control this case and that the facts of this case require viewing USWC as an "affected telephone company."

In its February 27, 1992 filing, Bridge Water argued that USWC's proposal incorrectly assumed that the Commission's Hokah Orders decided the matter for intraLATA routes, such as those involved in this case. Bridge Water noted that the proposed EAS routes under consideration in the Hokah Orders were all interLATA routes and argued that the Commission's holding in the Hokah Orders was limited to petitions involving interLATA routes.

In its reply comments filed April 27, 1992, Bridge Water acknowledged that in Orders subsequent to the Hokah Order the Commission had applied the holding in Hokah to intraLATA EAS routes. Bridge Water noted the Commission's Orders regarding the Loman-International Falls Calling Area routes (Docket No. P-407/CP-90-547; Loman Order issued March 25, 1992) and the Dodge Center to Concord and Claremont routes (Docket No. P-407/CP-90-723 Dodge Center Order issued December 17, 1991) where the Commission found that USWC was not an "affected telephone company" with respect to the intraLATA EAS routes proposed in those dockets.

Bridge Water argued, however, that the facts in the current Monticello case differed significantly from the facts in the Hokah, Loman, and Dodge Center cases and required finding that USWC is an "affected telephone company" for ILEC to ILEC traffic in this matter, i.e. for traffic between Monticello and all non-USWC exchanges in the MCA.

Bridge Water is correct in its view that the Hokah, Loman, and Dodge Center Orders do not automatically determine the Commission's "affected telephone company" decision in this or any

other docket. Each case is individually examined and decided on its own facts and merits. This does not mean, however, that the Commission is unmindful of relevant precedent. It is an important administrative goal to give like treatment to like cases. Applicable precedent will not be departed from except upon showing of good reason to do so. See the Commission's discussion and use of "affected telephone company" precedent in In the Matter of the Petition of Certain Subscribers in the Winnebago Exchange for Extended Area Service to the Blue Earth Exchange, P-403/CP-89-930, ORDER GRANTING PETITIONS TO INTERVENE AND FOR CLARIFICATION AND ADOPTING RATES FOR POLLING (July 2, 1992), pages 3-7.

The applicable principles of administrative law are clear. USWC's proposal not to offset its EAS costs with the toll revenue effect of EAS in calculating its proposed rates in this matter must be treated consistent with the precedent in Hokah⁴ unless the Commission finds 1) that Monticello is distinguishable from Hokah on material facts or 2) that there are sound reasons for treating these similar situations differently.

Bridge Water cited two facts that, in its opinion, distinguish the Monticello petition:

First: Bridge Water observed that the MCA has always been considered as a unit and that subscribers do not petition and receive access to only half or a quarter of the MCA. Apparently implied is that since the routes examined in Hokah and subsequent dockets did not involve the MCA, the statutory analysis presented in Hokah is inapplicable to the Monticello case. Bridge Water did not explain why this would be the case and the Commission does not find the distinction material. The Commission notes that any petition for EAS to a local calling area is a petition to the entire area, not just in the instance of the MCA. In processing EAS petitions, the Commission has consistently viewed LCAs as units. See, e.g. Loman's petition for EAS to the International Falls LCA. If the petitioning exchange seeks to meet the adjacency requirement as to a non-bordering exchange by reason of that exchange being a part of an LCA which contains an exchange that does share a border with the petitioning exchange,

⁴ The November 21, 1991 Hokah Order provided extensive analysis of the statute in question, Minn. Stat. § 237.161, subd. 3 (b) (1990). Hokah expressly interpreted the term and held that an interexchange company that carries toll traffic over proposed routes is not an affected company. The holding in the Hokah Order was upheld on reconsideration and has not been overturned by any subsequent Commission Order. In addition to the Loman and Dodge Center Orders cited by Bridge Water, the Commission has applied the Hokah precedent in four other EAS dockets: Winnebago, Docket No. P-403/CP-89-930, ORDER (July 2, 1992); Easton, Docket No. P-519, 403/CP-89-703, ORDER (July 6, 1992); Hallock-Kennedy, Docket No. P-407/CP-91-373, ORDER APPROVING RATES FOR POLLING (July 6, 1992); and Sherburn-Fairmont, Docket No. P-405/CP-89-1080 (August 18, 1992).

the petitioning exchange must seek and qualify for EAS to each of the exchanges constituting the LCA.

Second: In its April 27, 1992 reply comments, Bridge Water noted that, unlike the case in previous dockets examining the "affected telephone company" question, USWC will continue to carry traffic between Monticello and the MCA ILEC exchanges after EAS is installed. This is a material difference, according to Bridge Water, which will result in USWC collecting twice for the same traffic unless it is considered an "affected telephone company" and required to include the effect that EAS would have on its toll revenue in calculating its EAS costs and rates.

Bridge Water's double recovery argument is a variation of the windfall argument made in its initial February 27, 1992 filing and by the Department in Hokah and every subsequent EAS rate setting case involving the "affected telephone company" issue. The specter of windfall is overblown. The increase in income that USWC would experience as a result of eliminating toll revenue losing toll routes in this matter are minimized by two factors: 1) the small portion of Monticello's toll traffic that USWC carries as a result of recent intraLATA presubscription balloting and 2) the adoption of USWC's Incentive Plan requiring USWC to share its expense savings with ratepayers.

The Commission notes that if it began treating USWC's toll revenue effect as an EAS cost, it would be required to treat the toll revenue effect of EAS on IXCs currently serving these routes at a profit similarly, i.e. as an EAS cost, pool such "costs" together with other EAS costs thereby expanding the total EAS revenue requirement, adopt rates adequate to recover that expanded revenue requirement, and require on-going payments from the EAS revenue pool to the profitable IXCs to maintain their income neutrality. The result of such an approach, EAS ratepayers paying displaced IXCs for a service the IXCs no longer provide and which the ratepayers are already paying for in opting for EAS, is absurd.

More to the point, however, the Commission finds that Bridge Water's argument-from-the-consequences does not effectively rebut the detailed statutory analysis presented in Hokah and expanded in subsequent cases.⁵ The fact that USWC's balance sheet would be improved by installing the proposed EAS and eliminating its losing toll routes simply does not establish that the statute

⁵ The Commission has applied and expanded the Hokah analysis in two other EAS dockets: In the Matter of the Petition of Certain Subscribers in the Winnebago Exchange for Extended Area Service to the Blue Earth Exchange, Docket No. P-403/CP-89-930, ORDER GRANTING PETITIONS TO INTERVENE AND FOR CLARIFICATION AND ADOPTING RATES FOR POLLING (July 2, 1992), pages 10-11 and In the Matter of a Petition for Extended Area Service From the Easton Exchange to the Wells Exchange, Docket No. P-519, 403/CP-89-703, ORDER RECONSIDERING JUNE 11, 1991 ORDER AND ADOPTING RATES FOR POLLING (July 6, 1992), pages 8-9.

requires the Commission to treat the toll effect of EAS as an EAS cost, albeit a negative cost in USWC's case.

3) The Department

In its comments filed April 13, 1992, the Department stated the Commission's December 17, 1991 Dodge Center Order and its March 25, 1992 Loman Order adopted USWC's view that USWC should only be considered an affected telephone company in instances where it served either the petitioned or petitioning exchange, or both, for intraLATA toll routes.

The Department concluded that although it disagreed with the Commission's decisions in Dodge Center and Loman, these Orders constituted the law of the case and that, as a consequence, USWC need not include its toll contribution for Monticello to MCA ILEC exchange routes in its estimate of toll contribution. However, the Department recommended that the Commission require USWC to file a second set of rates, one including its toll contribution. The Department explained that it intends to appeal the Commission's final order on this issue and, if the Court of Appeals upholds the Department's position on this question and requires EAS rates that include USWC's toll contribution, the Commission will be able to adopt the appropriate rates without delay.

The Commission's Dodge Center and Loman Orders do not establish the law of the Monticello case as the Department stated. The law of the case concept applies to decisions made in the course of a particular case that then apply to the same issues arising between the same parties in that docket. The law of a particular case does not bind parties in other dockets. The Dodge Center and Loman Orders simply constitute precedent. The applicability of that precedent depends on the facts of the case at hand.

In its April 27, 1992 reply comments the Department acknowledged that the Commission's decision on the "affected telephone company" issue in the Monticello case was not already determined by its previous decisions and would have to be decided in light of Monticello's facts. The Department did not attempt to distinguish Monticello from the facts in Hokah, Dodge Center, and Loman, however. Instead, it expressed its general disagreement with those Orders and restated its argument that USWC would experience a windfall if it was not considered an affected telephone company for routes between Monticello and the MCA ILEC exchanges. The Department pointed out that a windfall is not defined by size but is a sudden and unexpected piece of good fortune or personal gain.

The Department's clarified windfall argument did not overcome the key weakness of that argument cited previously. See discussion of Bridge Water's windfall or double recovery argument, *supra* at page 8. The Department failed to confront the detailed analysis

of the statutory language presented in Hokah and expanded in Winnebago and Easton. The fact that USWC's balance sheet would be improved by installing the proposed EAS and eliminating losing toll routes does not change the statutory language that indicates, as found in Hokah etc. that the only "affected telephone companies" are the LECs serving the petitioning and petitioned exchanges.

Regarding the Department's recommendation that the Commission order USWC to file an additional set of rates calculated to include the toll revenue effect, the Commission is unwilling to require the Company to do this additional work in the absence of some likelihood that the Department will prevail in its appeal of this issue.

4) United Telephone Company

In its April 15, 1992 comments, United contested USWC's characterization of the Commission's January 29, 1992 Hokah Order as establishing that the statutory phrase "affected telephone companies" refers solely to the LECs serving the petitioning and petitioned exchanges. United asserted that USWC's interpretation of the January 29, 1992 Order mistakenly focused on one sentence of the Order rather than looking to the intent of the Hokah Orders. The Commission finds it more relevant to focus on the "affected telephone company" question posed in this docket rather than discussing whose interpretation of the scope of the Hokah Orders is more correct.

United asserted that the significant differences between USWC in this case and interLATA IXCs were not explored in the Hokah Orders. The differences cited by United were that in the current case USWC is both a LEC and an intraLATA IXC. United also noted that on intraLATA EAS petitions to the MCA USWC will continue to maintain a presence after EAS is implemented. Finally, United asserted that the administration and enforcement problems noted in the Commission's November 21, 1991 Hokah Order would not apply to USWC and no undue complication would be added to the EAS process as would be true of interLATA IXCs. United implied that those differences required a different result than the Commission reached in Hokah.

The Commission disagrees. Regarding USWC's pre-EAS dual role as an IXC and LEC and its post-EAS continued presence, United did not demonstrate how these facts would alter the statutory analysis adopted by the Commission in the Hokah Orders. As to administration and enforcement problems, the Commission's decision in Hokah was based on an analysis of the statutory language, not the administrative burden of treating IXCs as affected telephone companies. Nevertheless, that burden, contrary to United's assertion, would exist in this case as well and may not be totally disregarded. There are numerous IXCs carrying traffic between Monticello and the MCA. Securing cost studies from these companies and factoring their toll revenue

experience into the rates would pose a significant administrative problem that could further delay this process.

c. Commission Action

The Commission finds that the Monticello docket, in which USWC serves the routes in question solely as an IXC, is essentially similar to the Hokah-Northfield-Cannon Falls dockets that the Commission considered in issuing the Hokah Orders. Having examined the parties' arguments, the Commission finds no sound reason to deviate from the finding in Hokah that Minn. Stat. § 237.161, subd. 3 (b) (1990) refers solely to the local exchange companies serving the petitioning exchange and the petitioned exchange or exchanges and does not refer to IXCs that carry toll traffic over proposed EAS routes. USWC's toll revenue effect for routes between Monticello and MCA ILEC exchanges will not be included in calculating EAS rates in this docket. See Ordering Paragraph 2 on page 15 of this Order.

3. Cost of Money

a. USWC's 13.4 Percent ROE

In its cost study, USWC used a 13.4 percent return on equity. The Commission finds that this figure is within the bounds of reasonableness in the context of setting EAS rates in this case and will accept its use for that purpose. See Ordering Paragraph 3a on page 15 of this Order.

The Department asserted that the 13.4 percent return on equity figure that USWC used in its cost study was too high. The Department urged the Commission to require USWC to refile its cost study using a lower ROE proposed by the Department (12.5 percent) or simply adopt rates using the Department's recommended ROE. The Department predicted that adopting rates based on USWC's ROE would not leave the Company income neutral as required by the statute, but would increase the Company's income from these routes.

These are the same arguments that the Commission considered and rejected when it adopted EAS rates for North Branch, Cambridge, and Buffalo. See, e.g. In the Matter of the Petition of Certain Subscribers in the North Branch Exchange for Extended Area Service to the Minneapolis/St. Paul Metropolitan Calling Area, Docket No. P-421/CP-86-272, ORDER ADOPTING RATES FOR POLLING (May 22, 1992). Subsequently, the Commission considered and rejected the Department's request, based on the same arguments, that the Commission reconsider its decision in those three dockets. See, e.g. In the Matter of the Petition of Certain Subscribers in the North Branch Exchange for Extended Area Service to the Minneapolis/St. Paul Metropolitan Calling Area, Docket No. P-421/CP-86-272, ORDER DENYING PETITION FOR RECONSIDERATION AND REHEARING (August 18, 1992). See also In the Matter of a Petition for Extended Area Service From Plainview to

Rochester, Docket No. P-430, 421/C-91-35, ORDER ADOPTING RATES FOR POLLING (August 25, 1992) and In the Matter of a Petition for Extended Area Service From the Nickerson Exchange to the Askov, Carlton, and Moose Lake Exchanges, Docket No. P-407, 421/C-89-105, ORDER ADOPTING RATES FOR POLLING (September 22, 1992).

Ample considerations support the Commission's finding that USWC's use of a 13.4 percent return on equity is acceptable in the context of setting Monticello's EAS rates and does not result in rates that are outside the range of reasonableness. Among those considerations are the following:

1. USWC has found and the Department has never disputed that USWC used a reasonable method to calculate the 13.4 percent figure. In reconsidering this issue in a previous docket, the Commission reviewed information submitted by USWC regarding the process it used in calculating the 13.4 percent figure. The information showed that USWC had applied both the discounted cash flow and the capital asset pricing model to three groups of companies, the seven RBOCs, independent telephone companies and comparable risk non-regulated companies. USWC also checked its figure against an estimate of the expected return on the market average of stocks and the risk and return differential between common stocks and bonds. In the Matter of the Petition of Certain Subscribers in the Buffalo Exchange for Extended Area Service to the Minneapolis/St. Paul Metropolitan Calling Area, Docket No. P-421/CP-87-506, ORDER DENYING PETITION FOR RECONSIDERATION AND REHEARING (August 18, 1992) at page 3.
2. The cost of money is only one factor among many in an incremental cost study. Other factors are: the stimulation factor used to calculate the amount of additional facilities required by EAS is based on an estimate of increased traffic volume; expenses to operate and maintain EAS; depreciation, income taxes, ad valorem taxes and business fees. In this case, using the Department's proposed lower cost of money in the cost study would have a de minimis impact upon the EAS rates, the thing which ultimately must be found to be reasonable.
3. The 13.4 percent return on equity figure is consistent with but lower than the sharing threshold adopted by the Commission in USWC's incentive plan case. In that case, the Commission found that it would be appropriate for the Company to earn up to a 13.5 percent return on equity before it would be required to begin sharing its earnings with ratepayers. In the Matter of Northwestern Bell Telephone Company's, d/b/a U S West Communications, Proposed Incentive Regulation Plan, Docket No. P-421/EI-89-860, ORDER AFTER RECONSIDERATION AND CLARIFYING ORDER OF JUNE 7, 1990, 8.

b. Bridge Water's 13.5 Percent ROE

According to the Department's June 24, 1992 telephone company earnings investigation report, Bridge Water experienced a 15.02 percent ROE in 1991. In its report, the Department concluded that annual returns not exceeding 14.5 percent on equity were reasonable. In its cost study, Bridge Water used a 13.5 percent ROE and the Department recommended using a 12.5 percent ROE. Understanding the de minimis impact upon EAS rates that the small differences in ROEs referred to here would have, the Commission finds that the 13.5 percent figure used by Bridge Water in its cost study is within the bounds of reasonableness and will accept the cost study containing it and the rates based in part thereon. See Ordering Paragraph 3b on page 15 of this Order.

The Commission notes that in approving the use of a 13.4 percent ROE for USWC and a 13.5 percent ROE for Bridge Water, it is simply finding that these figures are adequate in the context of a determination of EAS rates for polling. Because of the unique circumstances and goal of EAS rate setting, the Commission's finding here is not precedent for the companies' return on equity in its next rate case. In the context of a general rate case, the Commission will approve a rate of return that is appropriate based on the facts presented at that time.

4. Miscellaneous Cost Study Issues

a. Bridge Water's Lease With an Affiliate

The Department noted that Bridge Water intends to lease facilities from an affiliate, its parent company US Link, to carry its EAS traffic to its meet point with USWC. The Department stated that it could not determine the acceptability of Bridge Water's cost study without examining that lease.

The Commission believes that it is reasonable for Bridge Water to provide a copy of that lease for Department review and will direct it to do so. See Ordering Paragraph 4 on page 16 of this Order. Transactions with an affiliate raise special concerns about the reasonableness of the transaction.

b. Eckles' Lower Carrier Common Line Charge

On November 21, 1991, Eckles and the Department agreed that Eckles would lower its Carrier Common Line Charge (CCLC) and its traffic recording rate. Although Eckles has implemented these rate reductions, it did not use the new lower rates in its cost studies. The Department recommended that Eckles be required to refile its cost studies, using the lower rates.

The Commission finds this recommendation appropriate. Cost studies should be based on current rates. In its refiled cost studies, Eckles will be directed to use the lower rates. See Ordering Paragraph 3c on page 16 of this Order.

B. Bridge Water's Lower Priced Alternative (LPA)

Minn. Stat. § 237.161, subd. 1 (c) requires that when the local calling area to which EAS is sought is the Minneapolis/St. Paul MCA the company serving the petitioning exchange must provide local measured service or another lower priced alternative to basic flat-rate EAS service. For its lower priced alternative, Bridge Water proposed Optional Extended Area Measured Service (OEAMS). Subscribers to this service would pay a flat rate for unlimited service in their current local service area (Monticello, Enfield and Big Lake) and a measured EAS rate for service to the MCA. Bridge Water proposed rates for OEAMS based on the rate relationship between residential one-party flat rate service and residential one-party measured service in a neighboring exchange served by United.

The Commission finds that the service provided by OEAMS is the kind of alternative envisioned by the statute. Bridge Water's method of calculating rates for that service, however, does not guarantee fair and reasonable rates. Simply applying another company's measured/flat rate ratio appears to cut too many corners.

The Commission will require Bridge Water to refile proposed rates for OEAMS. Bridge Water should develop more reliable rates by separately developing the two rate components (access and usage) and combining them. In calculating the access charge, Bridge Water should use the experience in other exchanges that offered measured service as EAS was implemented to the MCA. This experience, adjusted for relevant differences between Monticello and these other exchanges, may be used to estimate the number of Bridge Water's customers who will choose the lower priced alternative if EAS to the MCA is installed. Likewise, the usage generated by subscribers to the lower priced alternative in other exchanges should be used in estimating the usage level that will be experienced in Monticello, thereby providing a base to calculating the usage charge. See Ordering Paragraph 5 on page 16 of this Order.

ORDER

1. Within 30 days of this Order, Bridge Water Telephone Company (Bridge Water) and the telephone companies serving the exchanges comprising the Minneapolis/St. Paul Metropolitan Calling Area shall
 - a. determine, in light of the uniform rates of USWC currently in effect in the Elk River exchange, what percentage of the Monticello EAS revenue requirement will need to be allocated to the Monticello subscribers to meet the requirements of Minn. Stat. § 237.161, subd. 3 (a) (1990); and

- b. refile their cost studies and proposed extended area service (EAS) rates accordingly.
- 2. In their refiled cost studies and proposed rates filed pursuant to Ordering Paragraph 1, the companies shall
 - a. not include the toll contribution effect that U S West Communications, Inc. (USWC) has experienced with respect to the routes between Monticello and the non-USWC exchanges of the Minneapolis/St. Paul Metropolitan Calling Area; and
 - b. include the toll contribution effect that U S West Communications, Inc. (USWC) has experienced with respect to the routes between Monticello and the USWC exchanges of the Minneapolis/St. Paul Metropolitan Calling Area.
- 3. In their refiled cost studies and proposed rates,
 - a. USWC shall use a 13.4 percent return on equity;
 - b. Bridge Water shall use a 13.5 percent return on equity; and
 - c. Eckles Telephone Company (Eckles) shall use its current Carrier Common Line Charge (CCLC) and traffic recording rate.
- 4. Within 30 days of the date of this Order, Bridge Water shall file the facilities lease with U S Link or any other affiliate.
- 5. Within 30 days of the date of this Order, Bridge Water shall refile the rates for its lower priced alternative using the method for calculating access and usage changes indicated in the text of this Order. In calculating those rates, Bridge Water shall estimate 1) the number of Bridge Water's customers who will choose the lower priced alternative if EAS to the MCA is installed and 2) the usage generated by these subscribers. In making those estimates, Bridge Water shall have reference to the experience of neighboring exchanges offering measured service along with EAS.
- 6. Within 75 days of the date of this Order, the Minnesota Department of Public Service (the Department) shall file another report and recommendation. The report shall list the rates resulting from Commission decisions made in this Order, the Department's recommendation on those rates, and any rates proposed by the Department that result from those proposed changes.

7. Within 20 days after the Department files its report and recommendation, any party may file final comments regarding this docket.
8. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)